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SUBJECT: NEW TOBACCO STRATEGY ADOPTED

REF: BELGRADE 255 AND PREVIOUS

SUMMARY

1. (u) The Government of Serbia (GoS) adopted an action plan for tobacco production and trade on March 22 in order to smooth its relationship with the cigarette industry and at the same time permit ratification of the Central European Free Trade Agreement (CEFTA). The new strategy has been negotiated with the tobacco industry to resolve the threat posed by the elimination of a discriminatory excise tax that protected the domestic producers, a legacy of the privatization agreements that brought Philip Morris, British-American Tobacco and Japan Tobacco Inc. (JTI) to Serbia. (see reftel) Industry representatives expressed satisfaction with the strategy and the level of cooperation with the GoS. END SUMMARY.

FOUR MAIN PRINCIPLES

2. (U) In a press conference, Minister of Economy Predrag Bubalo said that the action plan is based on four principles: 1) equal treatment for all participants at the domestic and regional tobacco market; 2) long-term certainty for the development of tobacco industry capacities; 3) stability of budget revenues from excise taxes on tobacco products and a transparent system of taxes; and 4) adjustment of national legislation to comply with EU and World Trade Organization (WTO) rules.

3. (U) Milan Parivodic, Minister of International Economic Relations (MIER) and Coordinator of the Ministry of Finance, explained that this document, which will be applied from 2008 to 2012, regulates relations to the mutual benefit of both the state and the tobacco industry. He stressed the importance of the four leading tobacco companies in Serbia: Philip Morris International, British American Tobacco, Japan Tobacco International, and domestic investor Monus. The four cigarette producers together have invested more than EUR 1 billion in Serbia since 2003. In addition, the industry employs some 130,000 people, or about 6 percent of overall employment.

4. (U) Parivodic said that the action plan takes into account the new reality of CEFTA and adjusts the entire relationship between the state and the tobacco indust. Implementing its provisions requires that Parliament ratify CEFTA, amend the excise tax law and amend the tobacco law. The minister said that its provisions will maintain excise tax revenues, increase exports of tobacco products, and

provide incentives to agricultural producers to improve the quality of tobacco, which is more important than simply increasing volume. (Note: the excise tax unification will take effect only on January 1, 2008)

NEW MEASURES

15. (SBU) Vlatko Sekulovic, state secretary at MIER, said that the action plan would abolish discriminatory excise taxes, providing the same treatment to domestic and foreign cigarette brands by introducing a single excise tax. He added that customs duties will be increased from 15 to 57.6 percent on cigarette imports from countries outside CEFTA and Russia, and it is expected that this change will increase budget revenues by EUR 13 million. (Eugenio Sidoli, PMI country director, said that the EU had informally agreed to the tariff hike.)

16. (SBU) Sidoli told econ chief on March 28 that the excise tax changes will provide much more revenue to the GOS over time, but at the same time will help industry by shifting the burden more from the ad-valorem (percentage) excise to per-pack, specific excises. This reduces the incentive for producers to cut prices to gain market share.

17. (U) Vesna Arsic, State Secretary at the Ministry of Finance, said that the plan includes a measure that will provide incentives to cigarette producers for purchases of domestic tobacco. She said that the current obligation for domestic cigarette manufacturers to buy at least 50 percent of their tobacco from domestic producers will be cut to 20 percent this year and phased out as of January, 2008. At the same time, companies will be able to import, duty-free, a volume of tobacco equal to that procured in Serbia. Arsic said that the GOS will implement agricultural measures to encourage production of the necessary types of tobacco, with the aim of increasing the quality and competitiveness of domestic tobacco and creating conditions for exports based on domestic tobacco.

CIGARETTE PRODUCERS PLEASED WITH THE PLAN

18. (SBU) Representatives of the Philip Morris International (PMI), British American Tobacco, Japan Tobacco International, and domestic investor Monus support the plan. "Once implemented, the action plan will transform CEFTA from a threat into a business opportunity for domestic cigarette manufacturing, enabling the consolidation of domestic volumes and the development of exports," said Sidoli, at the press March 23 conference, praising the government for its cooperative stance. He added that the plan would introduce additional costs for the industry, but it represented an acceptable compromise. Sidoli told econ chief later that the plan, once implemented, will create enough predictability for PMI to continue investing in Serbia.

PLATFORM FOR THE NEGOTIATIONS WITH CROATIA

19. (U) Minister Parivodic said that Serbia would use the action plan as a platform in negotiations with Croatia within CEFTA over cigarette trade. He complained that Croatia has higher tariffs on cigarette imports from Serbia than on EU products, and various non-tariff barriers, together with the non-transparent system of excise taxes, effectively create a monopoly for domestic producer Tvornica Duhana Rovinj (TDR) in the Croatian market.

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